

Fiscal Services Division

# 2011 Accounting Action Plan



*Fiscal Services Division's Annual Plan  
To Enhance Financial Integrity*



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# 2011 Accounting Action Plan

## Executive Summary

The Fiscal Services Division (Division) is proud to present this sixth annual plan to enhance the financial integrity and accountability of our processes and procedures.

The Division seeks to create an environment which encourages employees to identify and implement improvements to better safeguard our members' financial security. The Division seeks to utilize industry best practices in committing to document administrative and internal controls and assure all requirements are communicated with all levels of staff.

In 2011, the Division will build on past successes and continue to improve by:

- Identifying, refining, and implementing enhancements for the development of the Comprehensive Annual Financial Reports
- Continuing our vital role in the seamless interface of PeopleSoft Financials and myCalPERS systems
- Adequately addressing all findings identified in the 2010 Macias, Gini & O'Connell, LLP Management Letter

This 2011 Accounting Action Plan represents our continued review and evaluation of the fiscal processes to exceed the needs of the California Public Employees' Retirement System (CalPERS) and safeguard our members' financial security for years to come.

## Goal and Objectives

The goal of this Accounting Action Plan is to continue to strengthen our internal accounting and administrative controls. The Division will accomplish this goal by completing the following objectives:

- Objective 1 – Address current findings in the latest Macias, Gini & O’Connell, LLP Management Letter.
- Objective 2 – Assist with and track the successful interface of the PeopleSoft Financials and my|CalPERS systems.
- Objective 3 – Build upon past successes regarding improvements to investment disclosures and the Management’s Discussion and Analysis section of the annual financial report.
- Objective 4 – Address and implement the new initiatives outlined in this plan.

## Fiscal Year (FY) 2009-10 Management Letter Items

### ***A. Recognition of Multi-Year Contract Expenses***

In FY 2009-10, CalPERS recorded certain expenses in the general ledger based on the encumbrance of multi-year contract amounts, which resulted in the recognition of expenses that had not yet been incurred. Expenses should be recorded in the fiscal year in which the related goods are received or services are rendered, regardless of the timing of contract authorization in accordance with Generally Accepted Accounting Principles (GAAP). As of June 30, 2010, CalPERS personnel analyzed expenses greater than \$100,000, by budget line item; expenses that had not yet been incurred were manually reversed out of the general ledger.

As stated in the Management Letter issued by Macias, Gini & O’Connell, LLP, the auditors noted that while the current methodology of the above processes assures that the financial statements fairly present, in all material respects, multi-year contract expenses, the process results in the following deficiencies:

- There is a risk that expenses less than \$100,000, by budget line item, are not recorded in the proper fiscal year in accordance with GAAP
- The process is inefficient as personnel were required to investigate the recorded multi-year contract expense amounts and manually correct certain amounts that were improperly recognized during the fiscal year

- Expenses reported in the Statement of Changes in Fiduciary Net Assets and supplemental Administrative Expenses Schedule had to be corrected for financial reporting purposes

As recommended by the Management Letter, the Division will explore alternative processes which will better meet CalPERS GAAP and budget-based reporting requirements. In addition, the Division will refine and modify the current procedures to address the deficiencies noted and ensure that accruals for multi-year contracts are appropriately reflected.

### ***B. Executive Review of Draft Financial Statements***

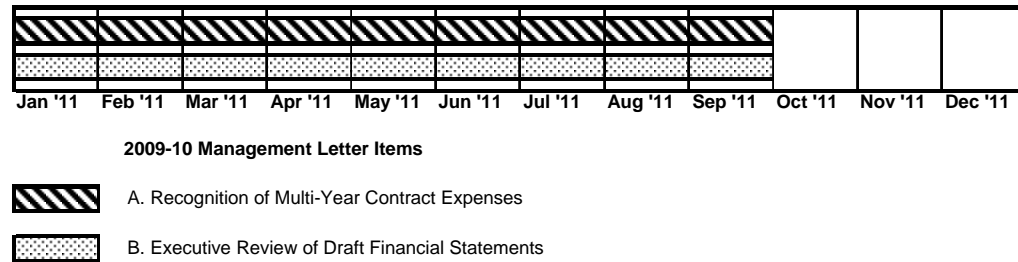
Currently, the Division does not have a process in place to ensure that all CalPERS executives have an opportunity to review the draft financial statements prior to being submitted to the Finance Committee for approval. It is Macias, Gini & O'Connell, LLP's recommendation that representatives from each of CalPERS Divisions and Offices have an opportunity to review the draft financial statements to ensure proper reporting and disclosure of CalPERS unique activities and services.

Macias, Gini & O'Connell, LLP strongly encourages the Division to distribute the draft financial statements to the appropriate executive personnel for review prior to the Finance Committee's approval of the financial statements. MGO further recommends that the Division develop a process to review and respond to comments and suggestions made by executive personnel to ensure that CalPERS financial statements offer readers the most thorough and transparent view of CalPERS financial activities and transactions.

It has been standard practice for various CalPERS executives and/or designees to have an opportunity to review draft financial statements. The Division will comply with Macias, Gini & O'Connell, LLP's recommendation to ensure that all other appropriate executive personnel, or their designees, have an opportunity to review and comment on the draft financial statements at an earlier date during our normal review process. In doing so, any concerns or comments can be addressed prior to presentation of the financial statements to the Finance Committee.

## Timeline for Resolving FY 2009-10 Management Letter Items

The table below represents the proposed timeline for resolving the FY 2009-10 Management Letter Items.



## Ongoing Activities

### ***A. Financial System Integration into Pension System Resumption Project***

The Division is providing significant resources to the Financial System Integration into Pension System Resumption Project (FSIP). The project began in 2008 when it was determined a gap existed between the my|CalPERS application and the financial system which utilizes a PeopleSoft Financials application. At the beginning of 2008, an effort was made to assess the gap between the two applications (systems). The result of this effort was the development of approximately 60 requirements which would need to be met by the PeopleSoft Financials application, with some modifications to the application being developed by the my|CalPERS. This work was accomplished using CalPERS subject matter experts directed by a team of Accenture consultants.

Subsequent work is required to enable the my|CalPERS application to interface with the accounting application. This includes detailing the requirements, developing the Functional and Technical Design documents, building the design into the PeopleSoft Financials application, and testing and implementation. The work is being accomplished under Accenture's direction by CalPERS resources in conjunction with Accenture consultants. The goal is to attain a seamless interface of receivables and payments between the PeopleSoft Financials and the my|CalPERS systems. FSIP is expected to be implemented with the my|CalPERS.

The timely execution of this project is critical to my|CalPERS success. The Division is the primary program area affected by FSIP and is working with "Stakeholder Divisions" (Employer Services Division, Employer and Member Health Services, Benefit Services Division, Actuarial Office, and Member Services Division). While the Division provides communication and works with the other Divisions to provide

subject matter experts to the project, it serves as the lone program division approving the various phases of the project.

Because the accomplishment of FSIP is critical to the success of the my|CalPERS, the Division has committed resources to the timely completion of this project. As a result, Division management believes it is prudent to provide an ongoing status report to the Accounting Action Plan Steering Committee to apprise them of the progress of the project and to alert them of any possible impact to other Accounting Action Plan tasks.

A briefing will be presented to the Steering Committee at each Accounting Action Plan Meeting. This report will provide a high level status on the project and recap the Division's resource commitment. Any potential challenges, delays, changes, as well as policy and/or procedure changes necessitated by the project will be presented.

## ***B. Risk Assessment Review***

The Division's vision is to be the national leader in public pension fund accounting. To achieve this goal, it is necessary to follow all pertinent accounting regulations. The Statement on Auditing Standards No. 109 (SAS 109), *Understanding the Entity and Its Environment and Assessing the Risks of Material Misstatement*, went into effect in December 2006. SAS 109 requires all entities to implement a risk assessment process that identifies, analyzes, and manages risks relevant to the preparation of financial statements that are presented in conformity with GAAP.

In previous Accounting Action Plans, the Division completed risk assessments for all CalPERS funds and sub-funds. These risk assessments were reviewed and a verbal approval was obtained from the external auditors. The auditors also noted that the provisions of SAS 109 should be ongoing and documentation should continue as part of the annual process. These results were reported to the Accounting Action Plan Steering Committee on a regular basis.

For the 2011 Accounting Action Plan, the Division will continue to monitor and document the risk assessment for all CalPERS funds and sub-funds and will also continue to research additional controls needed to prevent a material misstatement on the financial statements. Additionally, other areas that are being addressed through the Accounting Action Plan will enhance our efforts in addressing SAS 109.

### ***1. Long-Term Care Fund – Claims Payable***

Univita, the Third Party Administrator for the Long-Term Care (LTC) Program is responsible for preparing year-end accruals. During FY 2009-10, it was noted that Claim Payable Accruals for the LTC Fund prepared by Univita were originally classified as Other Liabilities on the financial statements. CalPERS current quality assurance process should include review of Univita's transactions before posting to the financial statements.

For the 2011 Accounting Action Plan, the Division will work with the LTC Program and Univita to implement a quality review process of supporting documentation in order to ensure proper posting of transactions in the general ledger as to account, amount, and time period.

### ***2. Long-Term Care Fund – Cash Reconciliation***

As the Third Party Administrator for the LTC Program, Univita is responsible for performing monthly cash account reconciliation. A copy of the monthly reconciliation is provided to the Division for review and posting of monthly transactions into CalPERS general ledger. Review of the June 30, 2010 bank reconciliation revealed numerous outstanding checks dating back to 2001; a majority of the outstanding checks were from the period of 2007 through 2009. Currently, there is no process in place to review and research outstanding checks.

For the 2011 Accounting Action Plan, the Division will work with the LTC Program and Univita to implement a process to timely research and clear outstanding checks and improve the communication process for stop payment notices. The Division will also work to standardize the proper accounting entry to record cancelled checks in a timely basis.

### ***3. Investments – Real Estate Commitments***

The Division produces a Total and Unfunded Commitments Schedule by Asset Class for the Comprehensive Annual Financial Report. This schedule includes the Real Estate Total and Unfunded Commitments based on the Allocation Report received from the Real Estate Investment Office. As of June 30, 2010, the Allocation Report contained discrepancies between the partner's and CalPERS records, thus creating an inaccurate report. Currently, the Division does not have a process in place to independently validate real estate unfunded



commitment amounts, and to ensure the amounts disclosed in the financial statement are accurate.

For the 2011 Accounting Action Plan, the Division will develop and implement a reconciliation process to prepare a more accurate Total and Unfunded Commitments Schedule using information from the June 30 Allocation Report.

#### **4. *Alternative Investments***

The Division records Alternative Investment Management transactions based on the quarterly financial statements submitted by the partners. During the external auditors testing of the final pricing, discrepancies were identified between the general ledger and the partners' financial statements. This was due to the fact that June 30 financial statements were not received from all partnerships resulting in the use of zero as the amounts for those missing statements. The Division corrected the discrepancies before the close of the fiscal year, but does not have procedures in place to avoid using zero amounts when financial information is not received from the partners. This could have caused the asset value of the Alternative Investments to be undervalued.

For the 2011 Accounting Action Plan, the Division will implement a process to ensure the June 30 financial information is received from each partner. Should the information remain unavailable, then the most recent financial statement information will be used for CalPERS final pricing adjustments. For any partnership requiring writing-off, the Division will coordinate with the Investment Office and use the Alternative Investment Write-Off Policy.

#### **5. *Investments – GASB Statement No. 53 Disclosures***

Effective FY 2009-10, CalPERS was required to implement GASB Statement No. 53, *Accounting and Financial Reporting for Derivative Instruments*. A review of the derivative data and draft footnote disclosure, noted the following issues in the original GASB No. 53 disclosures:

- Insufficient written documentation of the processes to obtain derivative data and preparation of note disclosures
- Delay in receiving derivative data from the custodian bank
- Insufficient validation of data provided by the custodian bank
- Heavy reliance on data provided by the custodian bank and failure to present the original disclosure in accordance with the requirements of the standard

For the 2011 Accounting Action Plan, the Division will:

- Enhance written documentation of the process for obtaining and preparing note disclosures for derivative instruments
- Will work with the custodian bank to ensure timely receipt of derivative data and work with the appropriate investment personnel to ensure completeness of derivative data received from the custodian bank
- Will independently validate and test the derivative data provided by the custodian bank
- The Financial Reporting Unit, in concert with the Investment Accounting Unit will document the process of obtaining and preparing the note disclosures for derivative instruments pursuant to the provisions of GASB No 53. Additionally, they will work more closely with State Street Bank to ensure timely and accurate data for the GASB No. 53 disclosures

#### ***6. Accounting and Reporting for Supplemental Income Program Funds***

Current processes contain inconsistencies for recording investment and administrative expenses for the Supplemental Income Program (SIP) Funds posted in the general ledger. Forecast amounts are estimated by using historical expense amounts billed by the investment manager, third party administrator, and the custodian bank. These amounts are later adjusted to reflect actual amounts. This process requires a year-end correction to ensure actual expenses are reported in the financial statements.

For the 2011 Accounting Action Plan, the Division will research, develop, and implement procedures to ensure that actual expenses and invoice amounts are correctly reflected and recorded at year-end in the general ledger for the SIP Funds.

#### ***7. Accounting and Reporting for Old Age & Survivors' Insurance Fund***

Under the provisions of the Federal Social Security regulations, the Old Age & Survivors' Insurance Revolving (OASI) Fund was established to consolidate the collection and payment for California public agencies of employee and employer contributions to the Social Security Administration (SSA). However, subsequent legislation enacted in 1986 eliminated this intermediary process and required individual public agencies remit such payments directly to the SSA. Currently, the residual resources in the OASI Fund have been utilized to reimburse CalPERS for contract management and related OASI Fund services. There are conflicting conclusions as to how the remaining balance in the OASI Fund should be recorded in CalPERS financial statements.

For the 2011 Accounting Action Plan, the Financial Reporting Unit will review the pertinent Government Code sections that established the OASI to determine whether the fund should continue to be used in this manner. Once the appropriate disposition of the remaining balances in this fund has been determined, the Financial Reporting Unit will then work with the Fund Accounting Unit, to draft a position memo to address the proper accounting and financial reporting treatment of the OASI Fund.

## **Conclusion**

The Division will continue to implement administrative and internal controls which will further ensure financial integrity through the processes identified in this plan. The primary objectives of this Accounting Action Plan include:

- Addressing outstanding audit findings identified by our external auditors
- Improving the process used to develop the Comprehensive Annual Financial Report
- Assisting with and tracking the interface of the PeopleSoft Financials and my|CalPERS systems
- Continuing our risk assessment efforts

This Accounting Action Plan represents our continued review and evaluation of the fiscal processes to exceed the needs of the department and safeguard our members' financial security for years to come.